United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

74-1244

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

ANTOINETTE M. BRAGALINI, ARNOLD DAMSKY, WILLIAM WEINSTOCK, CARL ROGERS and ROSE ROGERS, H. L. FEDERMAN & CO., INC., SUZANNE MASTERS, STEPHEN MASTERS and NORMAN KEMPER, individually and as Stockholders of MASTERS, INC., suing in behalf of themselves and for the benefit of said corporation and for the class of all other stockholders of said corporation similarly situated,

Plaintiffs-Appellants,

-against-

LOUIS BIBLOWITZ, MAX BIBLOWIT, JOSHUA BIBLOWITZ, RALPH J. WEINER, JOEL BIBLOWITZ, ARNOLD GINSBURG, HERBERT ABRAMSON, HARRY GRUNTHER, HARRY L. LEWIS, PINCUS PETERSEIL and MASTERS, INC.,

Defendants-Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF OF PLAINTIFFS-APPELLANTS

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REPLY BRIEF OF PLAINTIFFS-APPELLANTS

I

DEFENDANTS HAVE FAILED TO REFUTE PLAINTIFFS' SHOWING THAT THE DISTRICT COURT COMMITTED CLEAR ERROR OF FACT AND COMMITTED ERROR OF LAW IN HOLDING THAT THE MASTERS PROXY MATERIAL DID NOT CONTAIN MATERIAL OMISSIONS AND MIS-REPRESENTATIONS.

1. Failure To Disclose Biblowitz Control of Masters.

Plaintiffs' brief showed that the proxy statement did not state that the Biblowitzes exercised control over Masters and its Board of Directors (PB 3)*. Defendants' brief does not deny this but argues that "the inference of control is inescapable" from two statements in the proxy material (DB 50)*; namely, (1) that the three Biblowitzes "presented the Agreement of Merger to the Board of Directors of Masters for its consideration" and (2) that said "three individuals are Voting Trustees under a Voting Trust Agreement", which "Voting Trust Agreement controls a majority of the issued and outstanding capital stock of Masters." (DB 49-50). But the proxy statement (PX 2, Ex. D thereto, pp. 3-4) disclosed that

* All references to "PB" are to plaintiffs' main brief; all references to "DB" are to the brief of the individual defendants-appellees. Masters' brief merely "submitted" on the briefs of the plaintiffs and the individual defendants.

the Biblowitzes were only three of nine Voting Trustees so the stockholders would infer from the information given that the Biblowitzes were a minority of the Voting Trustees and therefore did not control Masters and its Board of Directors. This (erroneous) inference would have been strengthened by the proxy statement (DB 50) that the three Biblowitzes were "the controlling persons of Lady Rose and are the persons who presented the Agreement of Merger to the Board of Directors of Masters for its consideration" and (81A) "the terms of the merger were arrived at as a result of negotiation between the respective managements of Masters and Lady Rose".* The express statement of Biblowitz "control" over Lady Rose contrasts with the lack of a corresponding statement about their control over Masters and an illusion is created of a "negotiation" between two separate managements and of "consideration" by the Masters Board.

In all this there is a studied effort to conceal the Biblowitz control over Masters and its Board, certainly no

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* The District Court found (24A) that (a) "negotiations" in any meaningful sense between two corporations and (b) a single control over both of them, were incompatible concepts. So, by the District Court's own finding, the statement that the terms resulted from negotiation between separate managements implied lack of such control.

The District Court (16A), in erroneously finding a disclosure of control, evidently overlooked the fact that the Biblowitzes were, and by the proxy material were stated to be, only 3 of 9 Voting Trustees.

accurate statement of facts from which control is reasonably to be inferred by the average stockholder. Contrast the explicit statement of control over Masters by the Biblowitzes when Masters subsequently registered securities and its S-1 had to be cleared by the SEC staff (PB 3, n.).

Defendants' quotation (DB 50-1) from Lewis v. Dansker, 357 F.Supp. 636, 639, n.4 (S.D.N.Y.), shows that on the facts in that case control was "easily ... inferred"; that proves nothing about the different facts in our case.

2. Failure To Disclose That Lou Biblowitz Fixed The Values Of Masters For The Merger And What Masters Was To Get In The Merger.

Plaintiffs' brief showed (PB 4) that while Lou Biblowitz fixed the terms of the merger, including what Masters would get and what it would give, the proxy statement nowhere disclosed this. Defendants' only response to this (DB 42-50) is to point to the proxy statement that the Biblowitzes "presented the Agreement of Merger to the Board of Directors for its consideration". "Presentation" for "consideration" by the Masters Board cannot rationally be equated with "fixed by Biblowitz for Masters." That is especially so, since the proxy statement stated (81A) that "The terms of the merger were arrived at as a result of negotiation between the respective managements of Masters and Lady Rose". That statement squarely

contradicts the true fact that Lou Biblowitz fixed the terms of the merger for both.

The District Court said (17A): "Since the proxy statement disclosed that the Biblowitzes controlled Lady Rose, it would have to be assumed that they set the terms for Lady Rose." The District Court limited its assumption to Biblowitz setting "the terms for Lady Rose" but fails to discuss the all important failure to disclose the fact that Biblowitz also fixed the price for Masters. The District Court's statement about Lady Rose was not in issue and irrelevant.

The stockholder would understand from the express statements in the proxy material that the terms of the merger were "presented" by the Biblowitzes to the Masters Board for its "consideration" and that the terms of the merger were the "result of negotiation between the respective managements of Masters and Lady Rose." Thereby he was clearly deceived, because there was no "negotiation" by the "respective managements". The terms were fixed for both by Lou Biblowitz (TR. 1400).

3. The Illusory "Negotiation".

As noted (PB 4) the proxy statement stated (81A) that the "terms of the merger were arrived at as a result of negotiation between the respective managements of Masters and Lady Rose" and the District Court (24A) found that statement to be erroneous, as "negotiations ... would be virtually meaningless since the Biblowitzes controlled both managements."

Defendants (DB 51) characterize the use of the word "negotiation" as a harmless "inadvertence". But defendants assume, contrary to the case, that the proxy statement disclosed the Biblowitz control over both companies and disclosed that the terms of the merger were fixed for both companies by Lou Biblowitz.

Defendants also rely (DB 51) on the District Court's statement (24A) that the "poor financial condition"* of Masters rendered the misrepresentation immaterial. That is error of law in the light of Mills v. Electric Auto-Lite Co., 396 U.S. 375, 381, that failure to disclose sitting on both sides of the bargaining table is materially misleading and that the decision as to fairness is to be made by the stockholders who should not be by-passed by the court; see PB 55-6. Had the full facts been stated, as set forth id 56-7, the stockholders would have had an opportunity to appraise the situation more favorably than the District Court did; e.g. if they had been told the Masters losses shown were in fact due to the Florida operations that had been discontinued by the time of the merger and that the metropolitan stores had had profits (143A).

* The "poor mouthing" of Masters is not borne out by the facts (PB 10-15; infra 43-46). It stems basically from those who did not favor the merger; but values depend on the agreement of willing sellers and willing buyers, not of those who don't want to buy.

4. <u>Failure To Disclose That The Operating Losses Of Masters Shown Were Due To The Previously Discontinued Florida Operations</u>.

As plaintiffs' brief showed (PB 4-6), the proxy statement disclosed Masters' operating losses without disclosing that they were due to the Florida operations that were discontinued prior to the merger; the District Court found such omission to be ordinarily material (20A-21A; quoted, PB p.51); and defendants implicitly admitted as much because in the post-merger Masters 1969 public offering prospectus, the operating losses from the discontinued Florida division of Masters were shown separately, when it was to the issuer's advantage to do so and when the same accounting firm made the presentation (PB 5-6).

Defendants say (DB 52-3) that "segregation of the results of the operations of the Florida Masters stores does not meet the ... requirements" of a <u>1973</u> Accounting Principles Board opinion. We fail to see what this has to do with the case. As the District Court held (20A) it was required in 1966 when the proxy material was issued (as was done in 1969 in the post-merger Masters' S-1 prospectus) that the stockholders "should be informed ... to the extent possible, of the losses attributable to the discontinued operations".

Defendants do not deny that this was not done. Instead, they state (DB 53), lamely, that "the Masters shareholders

should have inferred that the Florida operation substantially contributed to the company's losses because the proxy statement disclosed that the sale resulted in a loss of some $561,367 (102A)". But that is not disclosure of the material facts that substantially <u>all</u> the losses shown were due to the discontinued Florida operation and that the metropolitan stores had shown profits (PB 4-5).

Defendants (DB 53) also rely on the District Court's excusing this ordinarily material omission because of "Masters' poor financial condition." But as we have noted (<u>supra</u>, PB 55-7) that is error of law under <u>Mills</u> (quoted PB 55), under Rule 10b-5 because the court cannot eliminate the opportunity of the stockholders to decide for themselves, based on a full statement of the material facts, whether the terms of the merger are as favorable as they - the stockholders - believe the terms, on those facts, ought to be. Indeed, as this Court held in <u>Sonesta</u>, see PB 56, even a generous offer would not excuse failure to disclose material facts. And in <u>Abramson</u> v. <u>Nyquist</u>, 312 F. Supp. 519, 526 (S.D.N.Y.), the court pointed out that management is required to supply its stockholders "with <u>all</u> the facts material to <u>independent</u> decision on the merits of the proposed transaction."

5. <u>Re Lady Rose Concessions:</u>

5(a) <u>Failure To Disclose That Lady Rose's Income Shown Included Income From The Previously Discontinued Florida Operation.</u>

Plaintiffs' brief (PB 6) showed that the proxy statement failed to disclose that Lady Rose derived 14.2% of its net income from its concessions in Masters' Florida operations discontinued before the merger agreement was made.

Defendants (DB 54) rely on the District Court's finding (22A, quoted id) that this omission was not material because of Lady Rose's "strong condition" and "large number of concessions." This gratuitously assumes that Lady Rose might conceivably be able to make up the income from other concessions yet to be located and obtained, on unknown terms. Moreover, as the Court stated in Abramson, supra, the stockholders are entitled to "all the facts material to independent decision on the merits of the proposed transaction" - not, under Rule 10b-5, only to the court's determination of the merits of the transaction.

5(b) Failure To Disclose Lady Rose Income From Masters Continuing Operations.

Plaintiffs' brief (PB 6) showed that the proxy statement failed to disclose that for fiscal 1966, 17% of Lady Rose's net income was derived from the Masters metropolitan stores, continuing after the liquidation of the Florida operation, and vulnerable to termination by Masters on short notice in the event of their sale. The District Court overlooked this omission.

Defendants (DB 55) offer speculation, but no evidence, that Lady Rose could have replaced these concessions, if terminated. Their speculation is contradicted by Lou Biblowitz's desire for the merger as a way of preventing such termination (see item 5(c) infra) and Rosenthal, one of Biblowitzs' surrogates, conceded that termination of the Lady Rose concessions in the Masters stores would have materially adversely affected Lady Rose (TR 1067-8).

Defendants (DB 55) mischaracterize the fact omitted as an "argument": plainly, earnings from terminable concessions are a fact, which stockholders, under the case defendants cite, Abramson, supra, at 526, are entitled to have so that they can make an "independent decision on the merits of the proposed transaction."

5(c) Failure To Disclose That One Of The Principal Reasons For The Merger Was That It Would Prevent Termination Of The Lady Rose Concessions.

As plaintiffs' brief (PB 7) showed, the proxy statements did not disclose that one of Lou Biblowitz's principal reasons for deciding to go forward with the merger was that it "will guarantee the continuance of [Lady Rose's] businesses in the Masters stores."

The District Court and the defendants have overlooked this omission.

This was not a mere "contention" as to the merits

of a proposed transaction. It was one of the principal reasons why the moving force had decided upon the merger.* It was highly material, as it went a long way to show what Masters' strength and bargaining leverage would have been had the terms of the merger been negotiated at arms length instead of being fixed for both companies by Lou Biblowitz, the one who stood to gain from suppressing this important fact that he wanted the merger in order to safeguard the Lady Rose concessions in the Masters stores from termination.

To demonstrate its importance, the Internal Revenue Service in issuing its written tax ruling on the merger determined the important, genuine business reason for the merger (123A) to be that (125A): "The merger of Lady Rose into Masters will guarantee the continuance of its [Lady Rose's] business in the Masters stores."

5(d) Failure To Disclose That No Value Given To Masters By Lady Rose In Terms Of Merger For The Valuable Assurance Of The Continuance Of Lady Rose Concessions In Masters' Stores.

As noted, one of Lou Biblowitz's principal reasons for deciding to merge was to guarantee the Lady Rose concessions

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* In Knauff v. Utah Construction & Mining Co., 408 F2d 958, 965 (C.A.10), the Court noted that in that case "the reasons and purposes of the merger were adequately disclosed" - implicitly holding, therefore, that "the reasons and purposes of the merger [must be] adequately disclosed."

in Masters stores against termination; yet, as plaintiffs' brief showed (PB 8); he paid nothing for it and the proxy statement did not disclose that nothing was paid for this important corporate advantage. Neither the District Court nor the defendants discuss this omission, on its face highly material. Not only did Lady Rose pay nothing for the Masters concessions, but the disclosure should have been made to the Masters stockholders that Lady Rose was charging Masters $1,400,000 (TR 800-2; 804-5, 807) for its concessions in the Masters stores, even though Masters had the legal right to terminate those concessions on a sale of assets (PB 29-30) and those concessions were due to expire on January 31, 1967 [only the expiration date of the Lady Rose concessions in the Masters stores was disclosed (92A)] and even though some were already discontinued.

The Court in the case cited by defendants (DB 55-6), Knauff, supra, noted that there "the reasons and purposes of the merger were adequately disclosed" (965). Here there was a total failure to disclose that one of the principal "reasons and purposes of the merger" was for the Lady Rose owners to acquire for nothing the guaranteeing of its concessions in Masters stores against termination and in fact, to charge Masters $1,400,000 for those concessions in the Masters stores, some discontinued. As the Court held in Kohn v. Amer. Metal Climax Inc., 458 F2d 255, 265 (C.A.3) (quoted PB 51-2), it is a

material omission to fail to disclose the benefits to be derived by the controlling corporation from a merger.

6. (a) Failure To Disclose That Masters'Tax Loss Carry Forward Was An Important Reason For Merger And That The Biblowitzes Were Paying Nothing For It.

The Proxy Statement (89A) buried a statement on page 9 that "7. Pursuant to I.R.C. Section 381(a)(2) and (c)(1), operating losses incurred by Masters in prior years may be carried over by the surviving corporation as an offset to possible future incomes." But as plaintiffs' brief showed (PB 8 item (a)), nowhere did the proxy statement disclose that the loss carry forward of $3,378,849 was an important reason why Biblowitz decided to merge and nowhere did the proxy statement disclose that he paid nothing for it in the terms of the merger (in fact it was utilized in full for tax savings of $1,905,000 by the surviving company).

Neither the District Court nor the defendants discuss these highly material omissions. Knauff, supra, and Kohn, supra.

6. (b) Failure To Disclose That Biblowitz Arbitrarily Deducted $900,000 From The Masters' Book Value.

As plaintiffs' brief showed (PB item (b)), the proxy statement failed to disclose that Biblowitz had arbitrarily

deducted $900,000 from the Masters' book value of $1,677,000.

The District Court and the defendants do not discuss this material omission.*

6. (c)** Failure To Disclose That Price Fixed For Lady Rose In The Merger Was $6,000,000.

The District Court did not discuss this material omission.

In this connection, defendants seek to distinguish Gerstle v. Gamble-Skogmo, Inc., 478 F2d 1281, 1294 (C.A.2), relied on by plaintiffs (PB 49-50) for the proposition that firm offers must be disclosed, by stating (DB 61): "In Gerstle, this Court considered whether the failure to disclose a firm offer emanating from outside sources was a material omission. Here there was no offer other than that made by Louis Biblowitz." Defendants' assertion is nonsense. In Gerstle, supra, the Court distinguished between a mere appraisal which ordinarily need not be disclosed and a firm offer which must be. In Gerstle, it happens that a third party offer was involved but the Court did not suggest that "inside" offers would be treated

* Defendants' bare statement (DB 26) that Lou Biblowitz's $1.71 per share for Masters was not arbitrary, is not supported by any basis for eliminating the $900,000 of book value.

** Item 6(c) on p.8 of PB is discussed in this Reply as Item 5(d) above at pp. 10-12.

differently. Indeed, there is even more need for disclosure of the insider's offer where the potential taint of self-dealing is ever-present. Since a stockholder is prevented from making an independent decision by not being told of a third party offer, he is as much prevented from making an independent decision, or more so, by not being informed of the insider's offer; especially where the insider's offer is determinative of the crucial terms of the merger.

6. (d) Failure To Disclose That Price Fixed For Masters In The Merger Was $777,000.

Plaintiffs' brief (PB 8, item (d)) noted that the proxy statement failed to disclose that the price fixed for Masters in the merger was $777,000.

The District Court, although finding that this omission was "obviously important" (22A), excused it because the District Court considered the terms fair (23A). As plaintiffs' brief argues (PB 54), that begs the question. It is for the stockholders to make an "independent" determination, so that "all" the facts must be given to them, Abramson, supra; Mills, supra. The District Court also excused the omission on the ground of Masters "poor" financial condition (23A). That begs the question for the same reason. The Court committed error of law under Gerstle, supra, in excusing the "obviously important" omission to disclose that $777,000 had been fixed as

the price to be paid for Masters; see discussion of Gerstle, supra, at pp. 13-14 , answering defendants' attempt to distinguish it, which discussion equally belongs here.

6. (e) Failure To Disclose That No Independent Appraisals Had Been Obtained.

As plaintiffs' brief noted (PB 8, item (d)) the proxy statement failed to disclose that no independent appraisals had been obtained. The District Court did not discuss this material omission.

Defendants argue that that omission is not material. As the sole predicate for their argument (DB 55-6), they cite Knauff, supra, which gives no support to their position. What Knauff held was, that no appraisal is necessary where "the merger agreement was reached by arms length bargaining" (408 F2d, at 964), the question being "whether in all the circumstances the negotiators exercised reasonably prudent judgment." (965)

Thus, in the first place, Knauff was discussing whether an independent appraisal was required, not our point that the proxy statement should disclose that no independent appraisal was obtained. Secondly, Knauff indicates that where it's not an arms length bargain, Rule 10b-5 does require an independent appraisal, and none was obtained here, where Lou

Biblowitz sitting on both sides of the table fixed the terms for both companies, his family company (Lady Rose) and the public company (Masters).

7. Failure To Disclose Kalish & Rubinroit's Lack Of Neutrality As Between Its Two Clients, The Parties To The Transaction.

Plaintiffs' brief (PB 8-9) showed that the proxy statement failed to disclose that Kalish, Rubinroit & Co. (having the duty to avoid favoring either of its clients - Masters and Lady Rose - over the other) were secretly working to maximize the Biblowitz-Lady Rose advantage in the merger over Masters.

The District Court (17A-19A) missed the point, concentrating on whether the dual employment was disclosed - not contested by plaintiffs - and not realizing that what the proxy statement failed to disclose was the accountants' disloyalty to Masters, i.e. lack of neutrality as between their two clients in the transaction.

Defendants (DB 56-7), simply quoting from the District Court, likewise miss the point. It is one thing for stockholders to know that accountants have been employed by both parties to a transaction. This entitles them to believe, in the absence of disclosure to the contrary, that the accountants will be neutral, not favor one or the other.

Failure to disclose Kalish & Rubinroit's lack of neutrality, disfavoring Masters, was highly material. Whereas they thought they had accountants who would protect their interests, those accountants were maximizing Lady Rose's advantage and not protecting Masters' interests.

8. Failure To Disclose Feldshuh & Frank's Incapacity To Protect Masters' Interests.

Plaintiffs' brief (PB 9) showed that the proxy statement failed to disclose that Feldshuh & Frank, Esqs., attorneys for Masters, were also attorneys for the Biblowitzes and therefore in no position to protect the interests of Masters. The District Court did not discuss this material omission.

Defendants appear to assert that the failure to disclose the conflict position of attorneys is not material. This position is not tenable. Defendants' sole support (DB 58-9) is a citation which holds nothing of the kind. Kohn v. Amer. Metal Climax, 458 F2d 255, 268-9 (C.A.3). There the Court held that during the negotiations for the amalgamation of RST and AMAX, Sullivan & Cromwell did not represent RST.

But in our case, during the very period of the formulation and effectuation of the merger terms and merger, Feldshuh & Frank did represent Masters and the Biblowitzes and were therefore in a conflict position not disclosed in

the proxy statement. Defendants do not assert or show the contrary. They say (DB 58), Lady Rose engaged special counsel; so what? The point is that Feldshuh & Frank, supposedly representing Masters were also Biblowitz counsel during the relevant period and this material conflict was not disclosed.* Had Masters engaged special, independent counsel, there would have been no difficulty. The Biblowitzes, however, did not do that and they did not disclose to the Masters stockholders that these latter were left to the mercies of Biblowitz counsel. That was a violation under the legal holding of the District Court in Kohn, which the Court of Appeals implicitly approved, the reversal being due to the District Court's "clearly erroneous factual premise that the firm [Sullivan & Cromwell] was in a conflict of interest position" (269).

9. (a) Failure To Disclose That One Director Voted Against the Merger.

As plaintiffs' brief showed (PB 10), the President's letter accompanying the proxy statement stated (80A) that "your Board of Directors has approved" the merger, whereas in fact

* Defendants (DB 57) take issue with, as unsupported, plaintiffs' statement (PB 9) that "as they materially expected to remain as the attorneys of the surviving corporation, controlled by the Biblowitzes, which in fact took place, the independence of their judgment and opinion was compromised." This, of course, was only stating in concrete terms the dangers of a conflict position; such dangers, in general terms, are, of course, a matter of law and judicial notice.

director Kurtz voted against it.

The District Court stated (20A) that it is "doubtful that reasonable stockholders would have construed Mr. Biblowitz's letter as stating that the vote of the directors was unanimous." Defendants overstate (DB 60) by asserting that "the District Court found that reasonable shareholders would not have construed the cover letter as stating that the directors' vote was unanimous (20A)."

We submit that the stockholders were entitled to know that in this Biblowitz self-deal a non-Biblowitz director considered it important enough to record his dissenting vote.

9. (b) Failure To Disclose That Several Directors Stated That Masters' Value Was At Least Equal To Lady Rose's.

As plaintiffs' brief showed (PB 10), President Biblowitz's letter to the stockholders stated that "Your Directors believe that the terms of the merger are fair and equitable", whereas in fact, not disclosed to the stockholders, the dissenting director disagreed "with the values that were reached as a basis for the merger"; some of the directors expressed the belief that the value of Masters for the purposes of the merger should have been $3,200,000, not $777,000; and several of the directors stated that Masters' value equalled or exceeded that of Lady Rose.* The District Court did not discuss these omissions.

* The price for which Lou Biblowitz fixed at $6,000,000.

Defendants (DB 60) mischaracterize these as "intermediate positions" of the directors. There is no indication whatsoever that the directors ever changed their positions as to these values. We submit that since Lou Biblowitz sat on both sides of the bargaining table and fixed the prices for both companies in the merger, the stockholders were entitled to the value opinions of the non-Biblowitz directors who were not personally profiting. Failure to disclose these were material omissions.

10. <u>Failure To Disclose Basis For Opinion Expressed To Stockholders That The Merger Was "Fair And Equitable".</u>

As plaintiffs' brief showed (PB 15-16), the President's letter accompanying the proxy statement asserted that in the opinion of the directors, "the terms of the merger are fair and equitable", but the basis of the alleged opinion was not stated. We submit that since Lou Biblowitz fixed the terms of the deal, it was a material omission not to state the basis for that opinion, especially since he did not disclose that he was paying nothing for two corporate advantages that he considered important reasons for making the merger; <u>viz.</u> the Masters loss carry-forward and its considerable power to terminate store concessions such as those of Lady Rose.

The District Court did not discuss this material omission at all. It simply stated (24A) that it considered the terms fair, which misses the point, because as pointed out,

under <u>Mills</u> and <u>Abramson</u>, <u>supra</u>, Rule 10b-5 requires that the stockholders be given <u>all</u> the facts so that they can make an <u>independent</u> determination of the merits of the transaction.

Neither do defendants confront the point. Their argument in substance is (DB 63 et seq.) that plaintiffs are not entitled to the full relief they seek if, assuming a violation of Rule 10b-5, the terms of the merger were nevertheless objectively fair; but that goes to the remedy, discussed below (p.68) and does not impair the validity of plaintiffs' position that since Lou Biblowitz fixed the terms of the merger for both Masters and Lady Rose, it was a material omission under the facts and circumstances of this case, to assert that it was the opinion of the directors that the merger was fair, without stating the basis of that opinion.

We next show that the defendants have failed to refute plaintiffs' position that the District Court committed error of law and clear error of fact in finding that the terms of the merger were objectively fair to the Masters minority stockholders. Plaintiffs need only demonstrate either, that Lou Biblowitz (whose values were accepted by the District Court even though he sat on both sides of the bargaining table and had a strong motive to favor Lady Rose, his family company, over Masters,

then substantially publicly held) priced Masters too low or Lady Rose too high. The fact is he did both. The net effect of that overreaching by the Biblowitzs was to shrink the interests of the pre-merger Masters stockholders, other than Lady Rose, from 85% to 10% in the post-merger Masters, whereas on a fair valuation, the public would have retained 38% of the surviving company (154A).*

* Post trial briefing and oral argument, normal after an extensive trial (transcript over 2000 pages) with hotly contested fact issues were, without explanation, eliminated by the District Court; instead the parties were confined to exchanging proposed findings of fact and conclusions of law, limited to 50 pages (Defendants' submission, without Court leave, was 58 pages); there was not even the opportunity of responding to the proposed findings of fact and conclusions of law of the other party.

II

DEFENDANTS HAVE FAILED TO REFUTE PLAINTIFFS' SHOWING THAT THE DISTRICT COURT COMMITTED CLEAR ERROR OF FACT AND COMMITTED ERROR OF LAW IN HOLDING THAT THE $777,000 LOU BIBLOWITZ PAID FOR THE BUSINESS ASSETS INCLUDING CORPORATE ADVANTAGES OF HIS CESTUI, MASTERS, WAS INHERENTLY FAIR.

Defendants have wholly failed to refute the following propositions fully documented in plaintiffs' brief:

(A) The Biblowitzes paid nothing for acquiring Masters' corporate advantage - the right to use the tax loss - worth at least $800,000 (PB 17-24, 59-63).

(B) Lou Biblowitz paid $777,000 for Masters' assets, worth (inclusive of that $800,000) some $2,550,000 (PB 24-39, 63-66).

We consider defendants' failure to refute these two propositions, successively, in the following two sections of this Reply.

A. Lou Biblowitz Paid Nothing For the Masters Loss Carryforward Which He Eagerly Sought And Which Was Worth At Least $800,000 (Determinable In The Merger Agreement Or, Arguendo, Treated There As An Open Item, And So Determined From The Actual Tax Savings Realized Therefrom.)

At a different place in their brief, defendants (DB 46) purported to look "to the actualities to test an expert's

appraisal"; but on the tax loss carryforward of Masters, defendants ignored the actualities - to wit, that over a 25 month period, Masters' tax loss was fully utilized for a cash benefit of $1,905,000 (70A). Even the District Court, though mentioning this salient fact in a footnote (70A),gave no weight to it in the decision.

Defendants, by failing to answer, concede the correctness of plaintiffs' argument that, as a matter of law, "The right to use the [tax] loss as an offset ... is valuable" (PB 59-63) and there is "no moral or legal obligation to give away any legal opportunity or advantage just because its owner cannot utilize it himself" (PB 62). Thus, as a matter of law, as in Pearlman v. Feldman, 219 F2d 173 (C.A.2) (PB 60-62), there has been a flagrant misappropriation by the fiduciary of a valuable advantage belonging to Masters, since neither defendants' expert nor Rosenthal negated a "possibility of corporate gain" to Masters and under Pearlman, supra, "if there was a possibility of corporate gain, they [plaintiffs] are entitled to recover." Here, there was more than a possibility (PB 20-21) and the benefit did quickly accrue in the amount of $1,905,000.

The sole issue* is how to value the Masters' corporate advantage - the right to use its tax loss carryforward. Plaintiffs' expert - stating in effect, that the question was

* I.e. in this connection.

novel - provided a conservative method (172A-173) which resulted in a value of $800,000. Defendants' expert and Rosenthal, a director of Masters under Biblowitzs' influence, "knew of no way to assign a value to a tax loss carryforward and that he knew of no instances in which a value had been assigned a tax loss carryforward" (DB 30). The District Court cited Rosenthal's testimony (46A); thus the District Court accepted lack of knowledge by Rosenthal as a justification (65A-66A) (answered PB 20-23), for deciding that the tax loss had a zero value. Judge Motley thus confused two items (i) a difficulty in valuing a tax loss carryforward with (ii) whether the tax loss was a corporate advantage of Masters. Defendants have now implicitly conceded by their silence that the tax loss was a corporate advantage.

Plainly, an independent board of directors of Masters would not have given a valuable asset away for zero merely because there was difficulty in valuing it. To further demonstrate (PB 17-18) that Lady Rose considered the Masters' tax loss valuable, we note that on January 20, 1967 Feldshuh and Frank in a letter to the Tax Ruling Division of the Internal Revenue Service (DX N, p.4) stated that:

> "Lady Rose ... will not proceed with the merger without the requested rulings."

Thus, Lady Rose's stated position demonstrates that it considered the tax loss of Masters to be such a valuable asset,

that without its availability, it would not proceed to merge.

There were two alternatives available, had the deal been at arms length: to value the tax loss carryforward fairly in the merger agreement, in the light of the decisive fact that Lou Biblowitz wanted and sought to obtain it so eagerly or, if a fair method of valuation had really escaped the knowledge of Lou Biblowitz and his aids at the time then to treat the value in the merger agreement as an open item to be fixed on the basis of the tax savings actually realized by the surviving company. On either basis $800,000 is a conservative value for the tax loss carryforward.

Defendants make the argument (DB 29) that Masters would not have been able to take advantage of the tax loss carryforward before its expiration through its own operations. But that was answered by Mr. Justice Jackson of the U.S. Supreme Court (PB 62), that there is no "legal obligation to give away any legal opportunity or advantage just because its owner cannot utilize it himself." Thus Masters, as an independent company, could have sought out other merger partners willing to pay for the tax loss, but in any event, since Lady Rose did appropriate it, the only issue now is what was the objectively fair value of it. Arguendo, defendants do not challenge the fact that representatives of Lady Rose projected that the first post-merger year (fiscal 1968) would show a

pre-tax net income of the combined company of $1,600,000, including $800,000 for Masters and $800,000 for Lady Rose (PB 28), thus envisioning full use of the tax loss carry-forward within three years, as in fact occurred. The above argument also refutes Whitman's position that "it was uncertain whether a combined Masters-Lady Rose operation would enjoy sufficient profits to fully utilize the carryforward" (65A); moreover, defendants do not answer or even attempt to answer plaintiffs' position (PB 21) that Whitman's speculation was outweighed by the actual utilization of the loss carryforward within 25 months (70A, 133A-134A). Arguendo, defendants' position (DB 35-6) that the accountants' statement was incorrect because utilizing the projected pre-tax net of Lady Rose would leave an unused carryforward loss of $674,468, does not answer the fact that over $2,700,000 of the tax loss (74A) was projected to be used and in any event, the accountants must have believed that the Masters' operation would yield sufficient profits to utilize the loss in full - this must necessarily be so since one of the accountants (Mintz) was present* when the projection of $1,600,000 pre-tax net for the combined operation was made, including $800,000 attributable to Masters (PB 28, PX 14) and that projection guaranteed full utilization of the entire tax loss. Thus contra defendants (DB 36), the expected extra earnings were due to come from Masters and not Lady Rose.

* All the Biblowitzs were also present (PX 14).

Plaintiffs refuted (PB 21-22) the District Court's reliance on Whitman that Lady Rose would have to assume the obligations of Masters including the obligations to the Creditors Committee. Plaintiffs' position (PB 22) was that that obligation of Masters had already been deducted in determining Masters' net worth and by considering it again in connection with the tax loss carryforward, Whitman, and the District Court, deducted it twice. Defendants (DB 36), by not even attempting to answer plaintiffs' argument, concede the point. Instead, defendants (DB 36) argue that meeting those obligations from Masters' working capital would further deplete it, but that argument has nothing to do with the value of Masters' tax loss and the fact that Lady Rose paid zero for this corporate advantage wanted so badly that it made the merger depend on a favorable IRS ruling that the surviving company would have it. Furthermore, Lou Biblowitz's projection (through Rosenthal), unrefuted, was that Masters would earn $800,000 pre-tax in the merged company (PB 28).

Thus defendants have abandoned reasons (i), (iv) and (v) of the District Court on the tax loss, which were answered fully by plaintiffs (PB 20-23); plaintiffs' main brief (PB 21-22) and our brief above (pp. 26-28) completely answer reasons (ii) and (iii).

Contra defendants (DB 36, footnote), there was an

original plan of merger (209A-210A) and Lady Rose was to receive 79.68% of the common stock of the surviving company (211A-212A); Lady Rose there was valued at $5,000,000 and Masters at $1,250,000 (211A).

Defendants concede that the final plan adopted (DB 37-38) permitted the surviving company to have available to it 100% of the Masters' tax loss carryforward. It is also conceded (DB 37) that under the plan of merger finally adopted, the Biblowitzes received the equivalent of 90% (89.95%) of the surviving company. If the Biblowitz interest consisted of 90% of common stock in the merged company, then 50% of the Masters tax loss would have been lost to the surviving company but because the common stock issued to the Biblowitzes (1,750,000 common shares) was slightly less than 80% of the total outstanding common stock, none of the Masters tax loss was lost even though the Biblowitzes in effect, increased their interest to 90% of the surviving company by causing Masters to issue to them, in addition, 1,750 shares of non-voting preferred stock (convertible* into 1,750,000 common shares). The above highly sophisticated plan further demonstrates Biblowitzes' tremendous appetite for the Masters' tax loss carryforward. This plan alone was powerful objective evidence of the value that the Biblowitzes placed on the Masters tax loss. For Lou Biblowitz, it was "heads I win, tails you (Masters) lose"; namely, Biblowitz, pre-merger, pays zero for the tax loss

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* On February 1, 1973 (80A).

and thereby (with the other undervaluation of Masters and overvaluation of Lady Rose) increases his interest to 90% of Masters, without losing any of the tax loss, and then proceeds to cash in the Masters' tax loss, after the merger, 100% in the amount of $1,905,000 tax dollars saved. We submit that the Biblowitzes conduct, instead of "'open' and 'honest'" as characterized by the District Court (27A), was greedy, unconscionable, inequitable and fraudulent.

Thus defendants (DB 29-30, 34-38) have practically abandoned the District Court's zero valuation for the tax loss of Masters by not mounting a credible argument against the facts adduced by the plaintiffs (PB 17-24) and completely defaulting on plaintiffs' conclusive legal argument (PB 59-63).

B. Lou Biblowitz Clearly Overreached Masters In Paying Only $777,000 When The Objective Fair Value Of Its Assets, Including The Tax Loss, Was $2,550,000.

1. Plaintiffs demonstrated (PB 38-39) that the District Court erroneously believed that, when the Biblowitzes purchased a controlling interest in Masters on April 11, 1963 at $1.15 per share, the working capital of Masters was $3,247,790 and its net worth $2,718,000 when in fact both were in a deficit position (PB 38, DX AL, Consolidated Balance Sheet as of April 30, 1963). Plaintiffs considered this an important error since the District Court, in comparing the 1963

arms length purchase of a controlling share of Masters at $1.15 per share, with the non-arms length valuation of Masters in 1966, by the Biblowitzes, at $1.71 per share, must have given weight to what it (erroneously) believed to be the stronger working capital and net worth position of Masters in 1963 as contrasted with 1966. From the lower stock price of Masters in 1963 ($1.15 per share) as contrasted with 1966 ($1.71 per share) the District Court must have (erroneously) inferred that the price of $1.71 per Masters share fixed by Lou Biblowitz was fair (PB 38).

Plaintiffs stated in their brief (PB 38) that the District Court erroneously referred to "defendants exhibit AH*, page 3,", which is totally unrelated, as its reference to support its erroneous statement on the net worth and working capital position of Masters on April 30, 1963, shortly after the purchase.

To support the District Court's findings, defendants erroneously state (DB 38):

> "Page 3 of Exhibit AH consists of the consolidated balance sheet and pro forma consolidated balance sheet (giving effect to the confirmation of the Plan). It is obvious that the District Court was aware

* Defendants exhibit AH is in fact a license agreement between Bargaintown Retail Centers of The Americas Inc. - Lady Rose Lawrence Inc. Actually the record indicates that exhibit AH was withdrawn by the defendants (TR 1455) and it does not appear that the defendants ever formally reoffered it.

> "that the quoted figures were those applicable after adoption of the Plan. No company whose current assets exceeded its current liabilities by some $3,300,000 with a working capital of approximately that amount would be in Chapter XI."

Thus defendants were representing to this Court that Defendants Exhibit AH was not as plaintiffs stated but an exhibit marked in evidence at the trial (TR 1523) as "AK". Plaintiffs' counsel had a photocopy of defendants' Exhibit "AK" as it was marked in the District Court and knew it was "AK" and not "AH" as stated by defendants; in addition, the parties' stipulation of February 22, 1974 under which the exhibits in the District Court were transmitted to the Court of Appeals properly identified "AH" as a license agreement totally unrelated to the District Court's stated point and to the defendants' use thereof in their brief here, in this Court (DB 38). Plaintiffs' counsel on September 24, 1974 inspected the exhibits on file in this Court and observed that the exhibit labels "AH" and "AK" had in fact been switched from the way they were in the District Court and the way they were when the record was filed in this Court. Defendants' counsel agreed to plaintiffs' request for a stipulation that the exhibits "AH" and "AK" and their labels be physically restored to the way they were in the District Court and as they were when the record was docketed in the Court of Appeals as per the stipulation of the parties dated February 22, 1974 (Appendix to

this brief - Stipulation dated September 24, 1974).

Therefore, it is clear that someone has illegally tampered with the exhibits AH and AK while they were lodged with this Court, in switching their respective labels. Defendants' brief (DB 38) sought to take advantage of that unauthorized switch in exhibit labels in this Court in an attempt to cover up the District Court's error in referring to exhibit "AH" which was totally unrelated to the purpose for which the District Court cited it. The District Court copied that erroneous reference "AH" from defendants' proposed finding No.8; evidently, the District Court never actually considered that exhibit in making its finding (31A) but blindly accepted defendants' citation to "AH" on its face without determining whether the proposition for which defendants cited it was supported by the exhibit (Cf. 31A with defendants' proposed finding No.8*). So defendants were seeking to exploit

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* Defendants' proposed finding No.8 states:

> "8. The purchasers of control of Masters in an arms-length transaction with members of the Masters family paid $1.15 per share (Tr. 764). After giving effect to the confirmation of the Plan, the current assets of Masters at April 30, 1963, shortly after that purchase, were $5,315,974, current liabilities were $2,068,184 (Exh. AH, p.3), its working capital was the difference, or $3,247,790 and its net worth was $2,718,092 (Exh. AH, p.3). Masters had a tax loss carryforward for the year ended April 30, 1963 of $274,045 (Exh. 1). And, with the disaffirmance of many leases held by it at the time of filing of the bankruptcy petition, its operations were then consolidated (Exh. 25, p.9)."

an illegal switch in exhibit labels to conceal the District Court's apparent copying from defendants without making independent findings based on genuine consideration of the evidence.

Thus the District Court made a finding as to the financial position of Masters on April 30, 1963 (shortly after the purchase of control of Masters at $1.15 per share) that was clearly erroneous. From that erroneous premise the District Court erroneously concluded that if $1.15 was fair in April 1963 when Masters was in a stronger financial position than it was on July 30, 1966, then it was fair to fix the value of Masters in 1966 at $1.71 per share.

Regardless of who tampered with the record exhibits in this Court, it seems perfectly clear that defendants' brief (DB 38) by design, attempts to misrepresent to this Court that "AK" is "AH" and thereby participates in the wrong by attempting to take advantage of the tampering with the Court exhibits. Plaintiffs submit that the wilful misconduct of defendants' counsel warrants most severe sanctions by this Court, against them and their clients for whose benefit they sought to mislead this Court. In any event, such fabrication betrays the lack of confidence in the merits of and taints, their defense.

Moreover, the true exhibit "AK", which defendants' brief here attempted to treat as "AH" and which the District

Court's opinion does not show that it ever considered, doesn't support the District Court's finding: if the District Court had examined that exhibit, it would have realized that the "current assets" of "$5,315,974", "current liabilities" of "$2,068,184", "working capital" of"$3,247,790", and "net worth" of "$2,718,092" (31A) only show up in the "Pro-Forma" column on page 3 which was after "giving effect to confirmation of plan of arrangement as described in note 1" (AK, p.3) and Note 1 states, <u>inter</u> <u>alia</u>, "In July 1963, the Creditors' Committee approved a plan of arrangement ..." Thus, the "pro-forma" referred to on page 3 of exhibit AK as of April 30, 1963 was only after adoption of the plan of arrangement in July 1963 (DX AK note 1) and confirmation on December 27, 1963 (DX AL, note 2). The favorable working capital and net worth of Masters, "found" by the court as of April 30, 1963, shortly after the purchase of control, in fact, as AK shows on its face, did not exist except upon the basis of confirmation of the plan of arrangement which was in December 1963; i.e. after the Biblowitz purchase of the controlling shares on April 11, 1963. When they purchased, Masters' working capital and net worth were both in a deficit (AK, p.3, first columns from the left). It is clear that the District Court did not even look at exhibit AK, or if it did, did not comprehend it. At the time of the Biblowitz purchase in Masters, on April 11, 1963, for $1.15 per share and even, as of April 30, 1963, as defendants'

own exhibit AK shows on its face, the financial position of Masters was in deficit and thus far weaker than Masters as of July 30, 1966 when its working capital was in excess of $1,800,000 (76A) and its net worth was $1,677,000 (75A). Since Biblowitz paid $1.15 per share, which fixed a value of $537,500 on the entire company* when Masters was in a deficit position, that April 1963 transaction is, in fact, evidence that the value of $777,000 placed on Masters in 1966 by Lou Biblowitz when it was in a much stronger financial position was definitely unfair and inequitable.

2. Rosenthal's projection of $800,000 pretax income for Masters in fiscal 1968, at a 1966 meeting with the Biblowitzes and their representatives, stands unrefuted (PB 28). At the pre-merger meeting, contemporaneous notes by Rosenthal projected $1,600,000 pretax income for the combined company in fiscal 1968, the first post-merger year, consisting of $800,000 for Masters and $800,000 for Lady Rose (PB 28). By its silence, defendants concede the point. That evidence supported the projection of plaintiffs' expert (165A) and demonstrates that the Biblowitzes were expecting to realize net income after taxes from Masters' metropolitan stores in line with profits of 2% to 2 1/2% of sales stated by the defendants (DB 13) to be needed.**

* 467,400 shares issued and outstanding as of April 30, 1963 (DX AK, p.3)

** Defendants (DB 7) refer to 2% to 2 1/2% on Masters' fiscal 1965 sales of $29,659,768, which included Florida's discontinued operations, so that sales volume is irrelevant.

3. Defendants are attempting to flim flam this Court, as they did the Masters stockholders in the Proxy Statement, by including the operations from the discontinued Florida stores in the operating results of Masters (DB 7-8). Plaintiffs' brief (PB 4-6) shows the operating losses for the discontinued Florida division which distorted the presentation of Masters' operations in the Proxy Statement and in defendants' brief. For example, defendants state (DB 7):

> "For the fiscal year ended April 30, 1966, Masters reported a net loss of $259,737 (97A) ..."

That is a distortion since $257,000 (147A) of that loss (virtually all of it) was from the discontinued Florida division.*

For the period May 2, 1964 through July 30, 1966, the discontinued Florida division showed operating losses of $379,850 and a <u>non-operating</u> loss on its sale to Zayre in July 1966 of $561,367 (total losses of $941,217); in that same period Masters' metropolitan stores showed a profit from operations of $110,099. It is noteworthy that a prospective purchaser of Masters' <u>metropolitan</u> stores, that operated both hard lines and soft lines, would view the Masters operations as including the concessions of Lady Rose and Rockower, which were subject to cancellation on a sale of assets, and as so consolidated, the Masters' metropolitan stores would have shown a pre-tax profit of about $550,000** for the 2 1/2 years ending July 30, 1966 (PB 29).

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* Conceded by defendants (DB 12).

** That earning power for Masters metropolitan stores is more objective proof of the value of those stores than the poor-mouthing by Biblowitzs' surrogates (DB 5-6, 8, 18-21).

4. Biblowitzes' surrogates poormouthed the condition of the Masters inventory (DB 6) but that is inconsistent with the Masters certified financial statements which showed the Masters inventory "at the lower of cost or market" for fiscal 1967 (DX F, p.2). Defendants relied on that financial statement in a different part of their brief (DB 14, footnote) for the fact "that operations for the fiscal year ended January 28, 1967 were fairly stated"; that statement by defendants means they concede that the inventories stated in that balance sheet are correctly valued at $2,027,382 as of January 28, 1967. Therefore all reference by defendants in their brief to the "soiled, damaged and stale" condition of the Masters inventory (DB 6) must be seen in its true perspective which is an attempt to rely on testimony in 1973 by Biblowitzes' surrogates to counter the conservative valuation of those inventories in the Masters' financial statements.

The Masters certified financial statement for the year ended January 28, 1967 showed a net worth of $1,329,313 (DX F, p.2) which took into consideration Masters' operations for its Metropolitan stores for the six month period July 31, 1966 through January 28, 1967. The reported loss of $339,000*

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* Loss from continuing operations for fiscal year ended January 28, 1967 at $360,000 (DX F, p.3) minus loss from continuing operations for six months ending July 30, 1966 at $21,000 (PB 5).

during that six month period increased the tax loss carry-forward of Masters by that amount (See PB 28-29, footnote). Thus the actual six month operating loss, while a reduction in net worth, increased the tax loss and its value.

5. Defendants rely upon the advice given to Lou Biblowitz by his brothers, by Kalish, Rubinroit & Co. and by Rosenthal against doing the merger (DB 24-25) but fail to point out that all of that advice was rejected. It is not the rejected advice that is important but on the contrary, the decision made by Lou Biblowitz to go forward with the merger recognizing that he had the ability to turn the situation around (PB 33), that he was interested in becoming the landlord and preserving the Lady Rose concessions (PB 33), that he wanted the tax loss carryforward (PB 17-24), and that he wanted the Masters name (PB 33). That conduct by Lou Biblowitz is the important persuasive evidence that Masters was indeed a viable situation, that it was his belief that Masters would produce a pretax profit of $800,000 before taxes and that it was his belief that Masters (after the merger) would utilize the tax loss carryforward to its fullest extent (PB 28 and above pp. 26-27). The District Court's reliance upon rejected advice (43A-44A), instead of upon the conduct of Lou Biblowitz in deciding to go forward with the merger, demonstrates the clearly erroneous nature of the District Court's findings. It is elementary that

value is fixed by willing buyers and willing sellers, not non-buyers or non-sellers.

6. Defendants give no credit to Masters for the valuable concessions Lady Rose held which were cancellable on relatively short notice on the sale of the Masters assets (PB 29-30). Moreover, the Lady Rose concessions were due to expire on January 31, 1967. This was a valuable right in Masters. No value was assigned to it. Instead, Lady Rose for the purposes of the merger had valued its concessions in the Masters stores at $1,400,000 on a stream of earnings calculation when in fact the value of those concessions was truly an asset of Masters which was subject to being transferred by Masters to an integrated operation that operated a soft goods line. Thus a double wrong was done to Masters in that that asset was appropriated by the fiduciary with nothing paid to Masters for it in flagrant violation of the rule of Pearlman v. Feldman, supra (PB 64) - not contested by the defendants - and the fiduciary charged Masters $1,400,000 for its own asset, by including that amount in the value of Lady Rose for its concessions in the Masters stores, some discontinued (PB 64, TR 800-2; 804-5, 807). Defendants, sub-silentio, concede the point.

Arguendo, the ridiculous proposition is asserted by the defendants that the concessions that Lady Rose operated in Masters were worth $1,400,000 as part of the Lady Rose assets

(PB 33-34) when at the same time they contend that Masters was in such a poor financial condition that its total value (because of their claim that it was on the verge of bankruptcy) was only $777,000. Lady Rose believed its concessions in Masters' metropolitan stores were worth $800,000 (PB 33-34). That demonstrates objectively that the value of Masters, with those concessions was worth an amount greatly in excess of $777,000. This is especially so when one considers the fact that the Masters' metropolitan stores, consolidated with the Lady Rose and Rockower concessions, showed a pre-tax profit of about $550,000 for the 2 1/2 years ending July 30, 1966 (PB 29). Defendants by their silence, concede the point. Any prospective purchaser that sold soft goods would have viewed the Masters' metropolitan stores as including the Lady Rose and Rockower concessions.

Thus, defendants by their silence, concede plaintiffs' arguments on the value of the Lady Rose concessions to Masters (PB 29-30, 33-34, 64-65).

7. Defendants take the position (DB 52) that "it would have been impossible to estimate the extent of the losses attributable to the discontinued Florida stores since defendants could not ascertain to what extent central overhead would be reduced as a result of the closings or how overhead expenses should be allocated between the Florida and metropolitan stores."

The District Court held (21A):

> "While it might well have been impossible to pinpoint the extent of the losses attributable to the Florida operations during the six month period ending July 30, 1966, the stockholders should at least have been informed that a substantial proportion of the losses were attributable to discontinued operations."

Contra defendants on their argument about central overhead, the fact is that defendant Masters, in its 1969 S-1 (147A) did separate out the "Operating loss from discontinued Miami Division" and showed the same losses for each period that was reported on the books of the Company* (Cf. 143A, ¶16 with 147A). Therefore that proves that Masters and its accountants, Kalish, Rubinroit & Co., in 1969 in an S-1, subject to clearance by the SEC, did believe that central overhead was properly apportioned on the Masters books between its metropolitan stores and its discontinued Florida stores for the relevant period. Furthermore, in its certified** financial statement for the fiscal year ended January 28, 1967, Masters showed the "Operating loss from discontinued Florida division" as a separate item (DX F, p.3) and for the same amount as per the Company's books (143A, ¶16) and as reported in its S-1 in 1969 (147A). Thus, it is apparent that all of the 1973 testimony about the impossibility

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* Not disclosed in the 1966 Proxy Statement.

** By Kalish, Rubinroit & Co.

of allocating central overhead as between the discontinued Florida stores and the metropolitan stores (DB 9-10,12) by Biblowitzes' surrogates was simply a litigation stance.

8. Defendants cite (DB 8) the District Court's finding (34A) that "In the opinion of Masters' counsel, its chief financial officer and its directors who testified at trial, Masters, in 1966, was headed for another bankruptcy." Defendants also cite (DB 11) the District Court's finding (33A) that "Masters financial condition in 1966, both before and <u>after</u> the sale of the three Florida stores to Zayre Corp., was <u>precarious</u>."*

The witnesses cited by the District Court were all Biblowitzes' surrogates and their 1973 testimony should be compared with Lou Biblowitzs' contemporaneous document addressed to the Masters stockholders under date of August 24, 1966, <u>after</u> the sale of the three Florida stores to Zayre, in which he stated (PB 13): "Your Company today is in a <u>good</u> working capital position" and "Your Company's efforts in the future, we anticipate, will enable the company to <u>continue to stabilize</u> its position in the merchandising field." Masters' working capital, <u>after</u> the sale to Zayre, on July 30, 1966 was in excess of $1,800,000, the same as Lady Rose (39A). In

* Emphasis supplied throughout, unless otherwise noted.

addition, Rosenthal by his contemporaneous notes of a meeting attended by the Biblowitzes and their representatives (PX 14) projected a pretax profit of $800,000 for Masters in the first post merger year (PB 28). The above trustworthy evidence plus other objective evidence (PB 14-15) demonstrate that Masters was <u>not</u> in a precarious financial condition after the sale to Zayre and was not headed for another bankruptcy. In fact, Kopelson, the Masters chief financial officer, testified flatly (TR 932)*:

> "Q. Would you say, sir, that on November 7 [1966] Masters was facing bankruptcy?
>
> "A. No."

Regarding the fact that the working capital of Lady Rose and Masters, at about $1,800,000, was approximately the same, defendants state (DB 16-17), "While this is true, it is, in vacuum, meaningless and misleading." Defendants further state and the District Court found that in the period 1964 to August 1966 the working capital of Lady Rose increased about 1 million dollars from $836,000 to $1,821,000 (39A) as contrasted to the fact that Masters had declined in the same

* The above testimony of Kopelson should be compared with testimony cited by the defendants (DB 8) to support the District Court's finding to wit, TR 871-872, which carried a major erroneous assumption "<u>if the losses aren't stopped,</u> then the company is headed for another insolvency proceeding".

period from $3,078,000* to $1,857,000. But we submit it is immaterial what the working capital of each company was in 1964 and therefore immaterial whether it went up or down to get where it was in July and August 1966. The important thing is that the working capital of Masters and Lady Rose was about the same in mid-1966 and that reflected that financial condition of each company as of that date.

The drop in Masters working capital between 1964 and July 1966, like its $888,000 decline in net worth from $2,565,000 (DX AL, p.4) to $1,677,000 (75A), is merely a reflection of the losses of $941,000** it suffered in its discontinued Florida division.

It was only after Masters agreed to sell off its Florida stores, which defendants' counsel characterized as an incubus (TR 874), that Lou Biblowitz considered and then, after the sale, decided to merge Lady Rose and Masters (PB 31).

For the District Court to characterize Masters' financial condition as of July 30, 1966, after the sale to Zayre, as "precarious" and "on the verge of bankruptcy" when its working capital was the same as Lady Rose - where Masters had sales of $18,000,000 and Lady Rose had sales of $13,000,000 -

* The District Court used a different period for the Masters comparison starting with April 30, 1963 (35A).

** Operating losses of $380,000 (143A) and non-operating loss of $561,000 (131A) on the sale to Zayre.

demonstrates that the District Court completely confused the meaning of the financial data.

Feldshuh & Frank's letter to the Internal Revenue Service (DB 18-21) refers to alleged transactions that Masters could not consummate because of its alleged "debilitating financial posture" (DB 20), but significantly, after the merger it did not consummate them either.

9. Defendants cite (DB 21-22) the testimony of Biblowitz and his surrogates for the proposition that Lou Biblowitz actively pursued a merger for Masters with other companies. The District Court held (39A):

> "The Biblowitzes attempted to find persons interested in buying Masters. However, little interest was expressed in purchasing the company. Only one offer was made. Under the terms of that offer, Times Square Stores would acquire Masters by paying Masters' shareholders out of any future Masters profits. This offer was rejected. (Tr. 880-881)."

But Mr. Kopelson testified that prior to November 7, 1966 the only company Lou Biblowitz mentioned to him was Times Square Stores (TR 918-919), and Kopelson further testified (TR 918):

> "Q. In fact, Mr. Biblowitz's reference to the Times Square Store to you was just an offhand reference, wasn't it?
>
> "A. You could characterize it as such.
>
> "Q. It was something that he had already discarded as an unworthwhile approach and he did not even go into any details with you, isn't that correct?
>
> "A. That is correct."

Moreover, Lady Rose had concessions in Times Square Stores (PX 133, p.11) which would have meant that the Lady Rose concessions in the Masters stores would not be cancelled. In fact, the companies typically approached by Lou Biblowitz were those which would virtually assure Lady Rose that its concessions in the Masters metropolitan stores would continue (TR 783-7, 309).

Some of the directors at the meeting on October 31, 1966 "stated that an opportunity should be had to ascertain whether any other company might be interested in purchasing Masters or in merging with it. Louis Biblowitz advised the members of the Board of Directors that he had already made inquiries along these lines which had not proved in any way successful." (DX AJ, p.7). At the adjourned meeting on November 7, 1966 "Certain of the directors again raised the question of whether it would be in Masters' best interest to attempt to interest other companies in acquiring or merging with it." (DX AJ, p.9). Thus it is clear from the above that Lou Biblowitz was interested in short circuiting any true outside interest generated by other directors and that he would either pick the merger partner to protect the Lady Rose concessions or protect those concessions by acquiring Masters for himself, in flagrant violation of his fiduciary obligation under <u>Pearlman</u> v. <u>Feldman</u>, <u>supra</u>.

10. Defendants state that their expert (DB 27-28) "used what he considered to be a meaningful market for the Masters stock"; to wit, creditors owning Masters subordinated debentures did <u>not</u> exercise their option to purchase Masters' shares at $1.25 per share. Instead said creditors insisted on their creditor position continuing in the merged company. Those creditors were also stockholders of Masters. Thus defendants expert took the outrageous position that the <u>failure</u> of certain creditors to exercise their option to purchase Masters shares established the market value of Masters stock. That position was mentioned and apparently accepted by the District Court (65A). It demonstrates confusion by the District Court since it accepted <u>non</u>-buyers instead of willing buyers - willing sellers as the test for market value. There could be many considerations that enter into a decision not to exercise an option. Here, one fair inference is that the creditors having observed the Biblowitzs' treatment of the stockholders of Masters in the proposed merger, did not want to enlarge their stockholder position and be at the further mercy of the Biblowitzs. It is hornbook law that <u>non</u>-buyers do not make market values. Thus the District Court's reliance on defendants' expert, who concededly (DB 27-28) had no market data with which to value Masters but relied on <u>non</u>-buyers as his "meaningful market", should be reversed as a matter of law.

11. Defendants contend (DB 33) that plaintiffs' expert never compared the subject merger with a situation where the acquired company was a Chapter XI company and unprofitable. But Masters for all practical purposes, was out of Chapter XI since it only had $393,000 in payments to make under the plan of arrangement and Biblowitz advised the stockholders on August 24, 1966 "that this will be liquidated within the course of the next fifteen months." (150A, PB 14). Moreover, one example of a transaction cited by plaintiffs' expert was that Floyd Bennett was acquired by one of its concessionaires, Spencer Shoe, even though Floyd Bennett was losing money and had a <u>negative</u> working capital of $1,016,000; yet Spencer Shoe paid <u>two</u> times Floyd Bennett's book value (PB 25-26). Defendants' expert's attempt to distinguish the Spencer Shoe-Floyd Bennett acquisition falls of its own weight (DB 33-34).

Plaintiffs' expert cited Marrud's stock price to establish that it was selling at 1.3 times its book value (PB 25-26); that is a proper use of market data as evidence of value. It uses willing sellers and willing buyers to fix value, contra defendants (DB 34), the accepted technique in valuing companies. In contrast, defendants' expert used <u>non-buyers</u> to establish value. Thus defendants wholly fail to rebut the market data cited by plaintiffs' expert (PB 24-

27, 163A-172A)*.

Contra defendants (DB 32) we have demonstrated above that Masters financial condition was not precarious after the sale to Zayre (also see PB 10-15).

Contra defendants (DB 32), plaintiffs' expert was a highly qualified securities analyst, who specialized in the retail area in 1965 and 1966 (153A, TR 1143, 1140-6) and it is unnecessary for securities analysts to have expertise in the actual operation of retail establishments. In contrast, defendants' expert did not at any time specialize in retail securities (TR 2094).

Contra defendants (DB 32) the fact that Masters obtained management for its hard goods division a year after the merger was immaterial. Contra defendants (DB 32) Marx corrected the rental rates (164A) and that did not change his opinion because the overall rate for Masters was relatively insignificant since he knew the actual rates Masters was receiving on its two biggest concessionaires, Rockower (164A) and Lady Rose.

Contra defendants (DB 31) plaintiffs' expert's projections for Masters were supported by Rosenthal, the Biblowitzes and their accountants (PX 14)since it is unrefuted

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* Plaintiffs' expert also cited the sale by Masters to Zayre (168A) at 77% of book value as part of his market data.

that Masters was expected to earn $800,000 pre-tax, in the first post-merger year (PB 28). Max Biblowitz also projected a Masters pre-tax profit of $174,000 for the three months ending January 28, 1967 (PB 28-29).

C. The Value of Masters

Put simply, defendants have no market data to support Lou Biblowitz's arbitrary valuation of Masters at $777,000 and the appropriation of its tax loss carryforward for zero. Plaintiffs' expert's opinion of $2,550,000, inclusive of Masters' tax loss, is fully supported by market data and in law. Plaintiffs' proof (PB 17-39) stands unrefuted and fully meets the test stated by the Supreme Court of the United States in Zenith v. Hazeltine, 395 U.S. 100, at 123:

> "The question for the appellate court under Rule 52(a) is not whether it would have made the findings the trial court did, but whether on the entire evidence [it] is left with the definite and firm conviction that a mistake has been committed [citing cases]"

In addition defendants, sub-silentio, concede plaintiffs' legal argument (PB 57 to 66).

III

DEFENDANTS HAVE FAILED TO REFUTE PLAINTIFFS' SHOWING THAT THE DISTRICT COURT COMMITTED CLEAR ERROR OF FACT AND COMMITTED ERROR OF LAW IN HOLDING THAT THE PRICE LOU BIBLOWITZ MADE HIS CESTUI, MASTERS, PAY FOR HIS FAMILY OWNED LADY ROSE - 6 MILLION DOLLARS - WAS INHERENTLY FAIR.

It is undisputed that the objectively fair price for Lady Rose depends on (A) annual earnings (B) to which is applied the proper price-earnings multiple.

A. <u>Lady Rose's Annual Earnings Were $480,000, Not The $600,000 Gratuitously Assumed by Lou Biblowitz.</u>

Defendants concede that the net income of Lady Rose for the fiscal year ended January 28, 1967*, the date of the merger, was $527,000 (DB 40); that the net income included $47,000 from Lady Rose's concessions in Masters' Florida stores (DB 40) that were discontinued during that fiscal year, to wit, in July 1966. Thus, Lady Rose's net income from continuing operations for the 1967 fiscal year was $480,000.** That

* 11 months, income for the month of February, 1967 was not significant (148A, see double asterisk).

** Includes $15,000 of net income from other discontinued operations (PX 133, p.8).

critical fact is conceded by defendants (DB 40, last line).

Plaintiffs' expert* in arriving at his valuation of Lady Rose of $3,720,000 (154A) instead of the $6,000,000 Biblowitz made his cestui, Masters, pay for this personal and family business, did in fact use a projected $480,000 net income for fiscal year 1967 (161A-162A; see plaintiffs' br., pp. 44-5).

Defendants' expert* used a projected income of $600,000 for Lady Rose for fiscal 1967 (64A). Thus defendants' expert utilized the Louis Biblowitz projection which was tainted by Mr. Biblowitz's desire to increase the earnings projection of Lady Rose in order to maximize the interest of the Biblowitzes in the merged company. The District Court, despite the fact that actual earnings from continuing operations were only $480,000, accepted the inflated projection of earnings for Lady Rose of $600,000. Inconsistently the District Court took special note of the actual operating loss reported by Masters for the quarter ended October 29, 1966 (36A-37A) even though the fact of that loss was not known until January 9, 1967 (178A), <u>after</u> the date of the directors meeting and of the proxy statement to the Masters stockholders.

The District Court stated that the projection of $600,000 "seems reasonable since, on the basis of the seasonal

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* Defendants' brief in discussing the testimony by the experts was very confusing since their sub-headings incorrectly referred to "Appellants' Expert" (DB 42) and "Appellees' Expert" (DB 45) when, in fact, the titles should be reversed.

pattern evidenced during the prior year, Lady Rose's earnings, with the Florida concessions, would have been $898,000 (TR 1843)" (45A), which is a citation to the testimony of defendants' expert. Thus the District Court closed its eyes to the actual operating results from continuing operations of $480,000 and justified the acceptance of a fictional $600,000 based on defendants' expert's opinion testimony that Lady Rose's earnings annualized would have been $898,000 on the basis of the prior year's performance. In fact, the pro forma of $898,000 for Lady Rose's earnings for the year, when compared to the actual earnings for that year from continuing operations of $480,000 (or even $527,000 from all operations) demonstrates that the defendants' expert was testifying irresponsibly; defendants' expert was estimating results for Lady Rose's second half year to produce net income of approximately $571,000 ($898,000 - $327,000; 45A) which in fact only amounted to $200,000 ($527,000 - $327,000). The District Court's acceptance of that grossly erroneous estimate as the basis for its acceptance of a $600,000 annual earnings projection, in the face of actual results of operations of $480,000 for the year chosen as the base for the valuation, produces a "definite and firm conviction that a mistake has been committed", Zenith, supra, at 123. As this court stated in U.S. v. Brooklyn Union Gas Co., 168 F2d 391 (C.A.2):

> "It would seem an eerie conclusion that a court must resort to guess, closing its eyes to reality, when its decision must actually be formulated after the true facts have become available. We think the evidence admissible not as a standard of value in itself, but for its bearing upon the prospective values at the time of taking."

Thus the District Court erroneously used $600,000, which was 25% more than the actual results from continuing operations for that 1967 fiscal year. By utilizing $600,000, estimated, instead of $480,000, actual, the District Court approved, at 10 times earnings, the fiduciary's overcharging the cestui by $1,200,000, at least.

Defendants' expert assumed that the net income from new stores opened by Lady Rose would replace the net income from the discontinued Florida operations (DB 42-43). But the fact is that in three of the four units it opened in fiscal 1967, Lady Rose was required to make an immediate writedown in the value of the inventory purchased (L. Biblowitz, TR 1409) and, it lost money in those three on a combined basis, in the next fiscal year (DX D, p.11, last three columns). Defendants' answer to the inventory writedown is worthless; they state (DB 44):

> "That a certain inventory write down was required as a result of opening new stores does not change the fact that new stores were opened"

So defendants are in the absurd position of saying that a net income loss from newly opened stores warrants inclusion in the base of profits from stores that have been discontinued: an absurdity fatal to the opinion of defendants' expert and the decision of the District Court that $600,000 is the proper earnings base for the Lady Rose valuation.

Included in the estimated earnings of $600,000 is Lou Biblowitz's estimate of $60,000 for the Lady Rose concessions in the Masters' Florida stores even though the Florida stores had been previously sold (L. Biblowitz TR 800-2; 804-5, 807; M. Biblowitz TR 364-5). At the multiple of ten that Lou Biblowitz used and the District Court accepted, the Lady Rose valuation was clearly excessive in that respect alone by the resulting amount of $600,000.

B. The Proper Price-Earnings Multiple Was 7, Not The 8 To 10 Opined by Defendants' Expert Without Rational Basis, And A Fortiori Not The 10 Arbitrarily Fixed By Lou Biblowitz And Adopted By The District Court.

Plaintiffs' expert, on the basis of comparable market data, concluded that the proper price-earnings multiple applicable to the Lady Rose earnings was 7 (158A); that this opinion was amply supported, see plaintiffs' br. pp. 39-44, 45-6. Applying this multiple, plaintiffs' expert arrived at a value

for Lady Rose of $3,720,000 (154A).*

Defendants' expert conceded (64A) that the value of Lady Rose was only 5 million dollars, at the lower end of the value range formulated as reasonable for Lady Rose, his high being 6 million dollars which is the price Lou Biblowitz made Masters pay for it. The District Court did not explain why it accepted the 6 million instead of the 5 million opinion of defendants' own expert. That 1 million dollar difference alone, would mean that Masters issued an excess of 583,333 shares to the Biblowitzes in the merger.

Defendants' expert utilized a straight price-earnings method, using 8 to 10 times earnings (DB 42). Arguendo, at the conceded 8 times fiscal 1967 net income from continuing operations of $480,000, Lady Rose's value would be $3,840,000. The experts' testimony in valuing Lady Rose would only be apart by $120,000. The District Court did not explain why it accepted the multiple of 10 instead of the 8 opinion of defendants' own expert. On a value for Lady Rose of $3,840,000, that alone would mean that Masters issued an excess of 1,260,000 shares to the Biblowitzes in the merger.

Defendants' expert employed a very simple device to arrive at the result of a "five to six million dollar"

* 7 applied to annual earnings of $480,000, yielding $3,360,000; rounded off to $3,350,000 and increased by $370,000 for the market value of its Masters holdings in excess of cost resulting in a Lady Rose fair market value of $3,720,000 in the opinion of plaintiffs' expert (154A). The District Court erroneously attributed a value of $3,350,000 to him (63A).

value for Lady Rose, which only makes a slick game out of the valuation process. Defendants baldly concede (DB 42-43) that if their expert had used the actual earnings of $480,000, then "Whitman's multiple would have been higher than 8 to 10" (DB 42). Thus defendants' expert, regardless of the multiples in the marketplace, would have arbitrarily utilized a higher multiple to achieve the result his client wanted. That is not objective valuation but raw partisanship.

Defendants contend (DB 45) that Zayre's acquisition of Hardline Distributors, its concessionaire, at 6.7 times earnings does not support plaintiffs' expert's multiple of 7 times because Hardlines was "in a poor negotiating position with Zayre's" because 70% of its leased departments were in Zayre's Department Stores but the defendants ignore the fact that the Hardline concessions in the Zayre stores would not expire until more than three years later (159A-160A). Absent the Biblowitz control, Lady Rose's negotiating position was even poorer than Hardline's because its Masters concessions were in greater imminent jeopardy than the Hardline concessions in the Zayre merger: (i) Lou Biblowitz conceded that he did not take into consideration the fact that the Lady Rose concessions in Masters' metropolitan stores were due to expire on January 31, 1967 (TR 799), (ii) in any bona fide sale of its assets, Masters had the right, on relatively short notice, to terminate any of its concessions (PB 30), witness the loss

of the Lady Rose concessions in Masters' Florida units when Masters sold those stores to Zayre in July 1966, (iii) the Internal Revenue Service determined the important, genuine business reason for the merger (123A) to be that (125A): "The merger of Lady Rose into Masters will guarantee the continuance of its [Lady Rose's] business in the Masters stores", (iv) if the Lady Rose concessions in the Masters stores had been terminated by Masters' merging with a full line discount store or otherwise, Lady Rose's condition would have been materially adversely affected (Rosenthal, TR 1067-8, 1073-4). The Biblowitzes, as a matter of law, cannot pay themselves for their control (Pearlman v. Feldman, 219 F2d 173 (C.A.2)); so the negotiating position of Lady Rose, for the purposes of the merger including valuing Lady Rose and its concessions, must be considered without giving any weight to control by the Biblowitzes. Since the IRS, pursuant to the request for a ruling, determined that the business purpose of the merger guaranteed the continuance of Lady Rose's concessions in the Masters' stores* and, as one of the Biblowitzes' surrogates conceded, termination of the Lady Rose concessions in the Masters' stores would have materially adversely affected Lady Rose, 7 times earnings, like the 6.7 times multiple in Zayre-Hardline, was fair.

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* The Biblowitzes conceded that the merger with Masters eliminated the risk of Lady Rose losing its concessions in the metropolitan stores of Masters (TR 1475, TR 232).

Defendants' argument (DB 45) that the 8 times multiple of leased department operators, like Unishops and Morse Shoe, which were far superior to the Lady Rose operation (PB 40-41), is"not dispositive" (DB 45), because the "value of the business" is in issue "not the value of shares of stock", demonstrates the critical failure of the report by defendants' expert, accepted in its entirety by the lower court; in that defendants' expert did <u>not</u> really rely on any market data, to wit, prices of shares of stocks or of businesses, upon sale, to support his appraisal of Lady Rose. That means defendants' primary position is that their expert's testimony is unsupported by any market data. We submit it is therefore strictly arbitrary and as a matter of law is entitled to no weight, thus clearly indicating the reversible error committed by the district court in accepting it in full.

Since the district court apparently relied upon defendants' expert's use of a multiple (64A), examination of the alleged basis of his opinion is highly pertinent. Whitman testified that his eight to ten times multiple was based on the index of "retail" companies filing annual reports with the Securities and Exchange Commission as of December, 1966; of the companies on this index, the average multiple was 9.1. (TR. 1885)." (64A) He conceded that there are many companies that are in the group used by him in arriving at the multiple that "are not comparable to Lady Rose"

(TR 1894-1895). His index included higher valued and non-comparable apparel and accessories stores (PX 156). Accordingly it was not representative of the market value of leased department operators and concededly his basis was not premised on an objectively sound method (Whitman, TR. 1885-1895).

Lady Rose was paying taxes, because of its multi-corporation arrangement, at a 33% rate (173A). One of the reasons that the leased department operators (like Lady Rose) sold at a low multiple compared to accessory, discount or department stores, was their low tax rate (173A); thus it is noteworthy that many of the companies on the index used by defendants' expert (PX 156) were also non-comparable because they were in a higher tax bracket, ranging as high as 51.6%. To further demonstrate how unrepresentative defendants' expert's sample was, it included J. C. Penney at 18 times earnings which was in a 43.7% tax bracket (PX 156). J. C. Penney, a full line department store chain, did billions in sales and yet that was accepted by the District Court as part of a sample for purposes of establishing a multiple for Lady Rose, a leased department operator with sales of 13 million dollars (PX 133, p.3).

The index and the raw average of multiples of companies on it could furnish no rational basis for defendants' expert's multiples of 8 to 10. The entire valuation of Lady Rose accepted by the District Court is thus without rational basis.

To further demonstrate the erroneous assumptions

underlying the opinion of defendants' expert, he emphasized (DB 45) the alleged strengths of the concessionaires like Lady Rose without considering their unrefuted and overriding weaknesses (PB 41-42, PX 17, p.2).

Another erroneous assumption of defendants' expert was that if the income Lady Rose derived from Masters were eliminated, it could obtain business elsewhere (DB 44, 41); that flies in the face of the opinion of Biblowitzs' surrogate that such termination would materially adversely affect Lady Rose (Rosenthal, TR 1067-8, 1073-4) and the actual poor performance from three of the four new concessions opened by Lady Rose during fiscal 1967 and fiscal 1968 (above, pp. 55-56).

The expansion in net income of Lady Rose (DB 44, footnote) was relatively small in relation to Morse Shoe which was selling at 8 times earnings (PB 40) and the number of Lady Rose's units was only approximately 10% of Unishops which had far greater diversification in its 200 units and yet was selling at 8 times earnings (PB 40-41). Defendants erroneously regard Lady Rose as engaged in an expansion program (DB 44) as long as new stores are opened, regardless of the closings. Moreover, the chart on store closings (DB 41) erroneously shows only <u>two</u> Lady Rose units closed in fiscal 1967 while at another place (DB 44) defendants concede "five were closed in fiscal 1967".

The fact that Lou Biblowitz valued Lady Rose's

concessions in the Masters' stores at $1,400,000 for the purposes of the merger (PB 33-34) demonstrates that Biblowitz followed a policy vis-a-vis his cestui, of "heads I win and tails you [Masters] lose"* The Lady Rose concessions in Masters including the closed Florida ones, were claimed to be worth $1.4 million while all of Masters was supposedly only worth $777,000 on the alleged theory Masters was facing backruptcy, but arguendo, if the latter were true, then the Lady Rose concessions in the Masters' stores were clearly overvalued at $1,400,000. The Biblowitzes, in net effect, made inconsistent assumptions to knock down the value of Masters and at the same time to build up the value of Lady Rose.

While the district court stated that Lady Rose's financial position "was much stronger" than Masters' (39A, DB 40), the fact is that their working capital was approximately the same at $1,800,000 as of July and August 1966 (39A). Arguendo, even if Lady Rose's financial position "was much stronger" than Masters', that did not justify the 9 to 1 ratio.

* Another example of that same philosophy, to wit, including the <u>profits</u> from the <u>discontinued</u> Lady Rose concession in Masters Florida stores which <u>enhanced</u> the value of Lady Rose, was to include the <u>losses</u> from Masters' <u>discontinued</u> Florida stores in valuing Masters, which also served the Biblowitzes' purpose of <u>reducing</u> the value of Masters.

Defendants state that (DB 41)

> "from year ending February 29, 1964 to eleven months ending January 28, 1967, Lady Rose income from Masters' metropolitan stores* dropped one-half; it went from 29.3% (February 29, 1964) ... to 15.9% (January 28, 1967) ..."

But that statement tends to conceal the more important fact that the income Lady Rose derived from Masters' metropolitan stores actually increased over 40% in the same period, to wit, from $59,121 for the fiscal year ending February 29, 1964 to $84,000 in the fiscal year ending January 28, 1967 (DB 40).

Contra defendants (DB 42), Rosenthal valued the combined Lady Rose-Masters operation at $6,694,740, not just Lady Rose (DX X). Moreover, the defendants' reference to 45A shows that the district court erroneously stated that DX X shows, respectively, a value of 9.03% to Masters and 90.97% to Lady Rose; in fact, while it shows 9.03% to Masters, that is coupled with 64.98% to the Biblowitz family and 25.99% to the public, which is totally different than the statement by the district court. Furthermore, no basis is shown for any alleged 9 to 1 allocation by Rosenthal, so any such allocation would be without any weight. In any event, Rosenthal at the time was seeking an underwriting from the Biblowitzes and as such participated in the fraudulent plan aimed at Masters; he could hardly be called an independent expert. In fact, when

* As a percentage of Lady Rose's total net income.

Masters went public approximately two years after the merger, at $16 per share*, the entire enterprise was being valued at over $17,500,000 (145A); that demonstrated that the merger was very successful and that Louis Biblowitz was right in recognizing the values in a merger between Lady Rose and Masters and right in rejecting the advice of his brothers, his accountants and Rosenthal.

Defendants (DB 46) point to the prosperity of the post-merger surviving company in fiscal 1968 and 1969, which they attribute mostly to a so-called Lady Rose division but post-merger prosperity can prove nothing about the pre-merger values of the separate companies because inevitably the post-merger value is attributable in substantial part to the merger itself and there is no way of abstracting the importance of the merger itself in order validly to argue back from the prosperity of a post-merger division to the value of a pre-merger company of the same name. In effect, defendants assume that only Lady Rose contributed to the value of the merger which is unsupported nonsense and belied by Lou Biblowitz's projection through Rosenthal of $1,600,000 pre-tax net for the combined companies for fiscal 1968 which projection allocated that income equally between the Masters and Lady Rose operations, $800,000 for Masters and $800,000 for Lady Rose (PX 14, pp.1-2,PB 28)**. It is also belied by Lou Biblowitz's avidity for the merger. If Masters had terminated the Lady Rose concessions, where would it stand

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* After a reverse split of the Masters shares.

** Defendants, sub-silentio, concede this projection.

financially? Biblowitz was afraid of the answer so he insisted on the merger. Moreover, where would Lady Rose be without the tax savings from Masters' loss carry-forward ? Lou Biblowitz was determined to get his hands on those for Lady Rose. The surviving company was using the cash savings in federal income taxes not paid in this period, amounting to approximately $1,848,000 (DX C, p.3); the source of those funds was from Masters' tax loss carryforward and the earnings of the merged company; it appears that those tax savings were being utilized in the Lady Rose end of the business (DX C, p.9) - thereby demonstrating that it would be unfair to claim that almost all of the earnings of the merged company were in the Lady Rose division when, in fact, that was due, at least, in substantial part to the use of a Masters' pre-merger asset, the saving from the tax loss carryforward. The merger facilitated a unified management which undoubtedly contributed to the success of the surviving company; it is arbitrary to give all the credit for that to Lady Rose. The merger facilitated purchases by a much larger company with greatly increased bargaining leverage vis-a-vis suppliers; how attribute that to any one part of the whole? The merger improved the efficiency of advertising by the enlarged company; plainly, the whole and not any of its parts taken separately can take the credit for that. Merger would also introduce over-head economies attributable to the surviving company rather than to any of its units alone. Lou Biblowitz projected Lady Rose and Masters economies from the merger (TR 456-7).

Consider also the matter of joint expenses withcut any showing by defendants of how they were allocated. The fact is that there was no separation of operations between Masters and Lady Rose units after the merger on January 28, 1967, except for the four units opened in fiscal 1967 (DX D, p.9). Contra defendants (DB 46), Lady Rose and all its subsidiaries were merged into Masters under the plan of merger (124A). Thus any attempt to separate out the operations of Lady Rose from Masters had to be on the basis of arbitrary allocations of many items of expense made by the Biblowitzes and their accountants, under Biblowitz influence, knowing that this action had already been commenced.

Indeed, Kalish & Rubinroit, the accountants for Biblowitz and for the pre-merger companies and the surviving company, acknowledged the irrelevance of post-merger divisional data to the valuation of the pre-merger companies: in pre-trial discovery they refused plaintiffs access to the financial data for the period subsequent to January 28, 1967, the date of the merger, allowing examination only of the data for the antecedent period.

C. The Value of Lady Rose

In short, defendants' attempted support of Lou Biblowitz's arbitrary 6 million for Lady Rose, adopted by the District Court without rational basis, falls flat on its face. Plaintiffs' expert's opinion of $3,720,000 is fully supported

by the actual earnings of $480,000* (for the measuring year chosen by Lou Biblowitz himself) multiplied by 7, which squares with the actual comparable market data.**

IV

CONCLUSION

The record discloses a shocking disproportion in the ratio of exchange fixed by Lou Biblowitz in this self deal - favoring his family and himself by a 9 to 1 ratio, whereas the public stockholders should have received at least 38% of the surviving company. Revision of the terms of the merger to a ratio of 38% for the public stockholders instead of the 10% Lou Biblowitz gave them in the surviving company is therefore required both under federal securities and state fiduciary law; e.g. Gerstle v. Gamble-Skogmo, Inc., 478 F2d 1281 (C.A.2); Norte & Co. v. Huffines, 416 F2d 1187 (C.A.2); Pearlman v. Feldman, 219 F2d 173 (C.A.2); Ripley v. IRCA, 8 NY2d 430.***

"Rigorous scrutiny" on the "inherent" fairness of the transaction which Pepper v. Litton, 308 U.S. 295, requires

* After excluding the $47,000 from the terminated concessions.

** See footnote on p. 57 , supra. Even taking the defendants' expert's 5 million or his multiple of 8 means that Lou Biblowitz, and the District Court, grossly overvalued Lady Rose. See p.57 supra.

*** We need not, therefore, delineate the full scope of the appropriate remedy for a 10b-5 violation with a hypothetical fair transaction, which includes at least costs and a reasonable plaintiff's attorneys' fee, Mills v. Electric Auto-Lite Co., 396 U.S. 375.

because Lou Biblowitz fixed the terms both for himself and his cestui and application of the rule of compensation from the fiduciary Biblowitzs for every "possible" "corporate advantage" taken from Masters, their cestui, as required by Pearlman v. Feldman, supra, as well as analysis of the record in light of the command of Rule 10b-5 that the management supply its stockholders "with all the facts material to independent decision on the merits of the proposed transaction" Abramson v. Nyquist, 312 F.Supp. 519, 526 (S.D.N.Y.), Mills, supra, expose the errors of law and clear errors of fact committed by the District Court.

The decision below cannot stand as against this Court's insistence upon full compliance with the requirements of 10b-5 and the high standards of conduct required for fiduciaries in dealings with their beneficiaries; Gerstle, supra, Pearlman v. Feldman, supra.

The judgment should therefore be reversed and remanded with the instructions requested, PB 69.

Dated: October 4, 1974

Respectfully,

LEVENTRITT LEWITTES & BENDER

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UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

AA

ANTOINETTE M. BRAGALINI, et al.,

Plaintiffs-Appellants,

-against-

LOUIS BIBLOWITZ, et al.,

Defendants-Appellees.

74-1244

STIPULATION

IT IS HEREBY STIPULATED AND AGREED by and between the parties that the Clerk of the Court be and he hereby is directed to:

(1) physically remove the label "Defendants' Exhibit AK" from the document entitled "License Agreement between Bargain Town Retail Centers of The Americas Inc. and Lady Rose Lawrence Inc." herein referred to as the first document,

(2) physically remove the label "Defendants' Exhibit AH" from the document entitled "Masters Inc. and Subsidiaries Financial Statements April 30, 1963" herein referred to as the second document,

(3) physically attach the label "Defendants' Exhibit AH" to the first document, and

(4) physically attach the label "Defendants' Exhibit AK" to the second document,

thereby restoring these documents and their exhibit labels as they were in the District Court and as they were when the record was docketed in the Court of Appeals as per the stipulation of the parties dated February 22, 1974.

Dated: September 25, 1974.

Leventritt Lewittes & Bender
By Sidney Bender

Attorneys for Plaintiffs

Shea Gould Climenko & Gould

Attorneys for Individual Defendants

By: [illegible] L. Ellis

AB

Elias Schmid & Schmid
Attorneys for Defendant Masters, Inc.

SO ORDERED this 27th day

of September, 1974

WILFRED FEINBERG
U.S.C.J.

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Elias, Schenel, & Schwartz